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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. [redacted] 102

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

Petitioners,

v.

GULF, MOBILE AND OHIO RAILROAD COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI

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INDEX

PAGE

Petition for Writ of Certiorari:

Jurisdiction 1
Opinions Below 1

Summary Statement of the Case 2

Statement of Facts 3
Questions Presented 14
Reasons Relied on for the Allowance of the Writ 15

POINT I—The instant case is in conflict with the decision of this Court in *La Buy* v. *Howes Leather Co.*, 352 U. S. 249 17

POINT II—The instant case is in conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica* 19

POINT III—The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western Pacific R.R. Corp.* v. *Western Pacific R. R. Co.* 25

POINT IV—The decision below is in conflict with the decisions of the Court of Appeals for the Tenth and Second Circuits and for the District of Columbia in *Durnett* v. *Auer*, *Hughes* v. *Securities & Exchange Comm.*, and *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.* 28

PAGE

POINT V—The decision below is in direct conflict with an important provision of the plan of reorganization of the Alton Railroad Company, which became final on May 31, 1947, after approval by the Interstate Commerce Commission and the Federal District Court having jurisdiction 30

POINT VI—The decision below is in conflict with the unmistakable trend of the decisions of all the Federal Courts in this century 32

Conclusion 51

TABLE OF CASES CITED

Bawden v. *Midland Steel Co.*, 254 Ill. 464 28

Chicago, Burlington & Quincy R. Co. v. *Boyd*, 118 Ill. 73 30

Durnett v. *Auer*, 71 F. 2d 912 28

Gratz v. *Claughton* (C. A. 2), 187 F. 2d 46, cert. denied 341, U. S. 920 ..... 35, 36, 37

Hooker v. *Midland Steel Co.*, 215 Ill. 444 28

Huck v. *Chicago & Alton R. Co.*, 86 Ill. 350 30

Hughes v. *Securities & Exchange Comm.* (C. A. 2), 139 F. 2d 434 ..... 28, 29

Joliet & Chicago R. R. Co. v. *United States* (1941), 118 F. 2d 174 30

La Buy v. *Howes Leather Co.*, 352 U. S. 249 ..... 15, 17, 18

PAGE

Mansfield Hardwood Lumber Co. v. *Johnson*, 263 F. 2d 748 28

Norris & Hirschberg, Inc. v. *Securities & Exchange Comm.* (D. C. App.), 177 F. 2d 228 ..28, 29

Pearlman v. *Feldmann* (C. A. 2), 219 F. 173 39

South Western R. Co. v. *Benton*, 206 Ga. 770 43

Speed v. *Transamerica Corp.*, C. A. 3, 235 F. 2d 369, affirming 99 F. S. 820 ..... 15, 19, 20, 21, 22, 23, 24

Strong v. *Repide*, 213 U. S. 419 28

Union Mutual Life Ins. Co. v. *Frear Stone Mfg. Co.*, 97 Ill. 537 26

United States v. *Cumberland Public Service Co.*, 338 U. S. 451 ..... 11, 49

United States v. *Gypsum Co.*, 333 U. S. 364 3

United States v. *Joliet & Chicago R. Co.*, 315 U. S. 44 39

Western Pacific R. R. Corp. v. *Western Pacific R. R. Co.*, 206 F. 2d 495, cert. denied 346 U. S. 910 ..... 15, 16, 25

Zahn v. *Transamerica Corp.* (C. A. 3), 162 F. 2d 36 29

Other Authorities Cited

	PAGE
58 Col. Law Rev. 452, 455-459	18
Commerce Clearing House, Standard Federal tax reports No. 5, January 11, 1950	11
Federal Securities Exchange Act of 1934	2, 29
Illinois Private Laws 1861, p. 497	4
Illinois Statutes 1855, pp. 263 *et seq.*	4
Prentice-Hall, weekly Federal Tax Report Bulletin, January 12, 1950	11
Professor Loss, Securities Regulations (1951 ed. p. 835)	19
Securities Exchange Commission Rules:	
Rule X-1013-5	2
Rule X-10 B-5	20, 29
"Taxes, the Tax Magazine", February, 1950, p. 104	11
28 U. S. C. 1254 (1)	1

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PETITION FOR WRIT OF CERTIORARI

To the Honorable The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioners respectfully pray that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Seventh Circuit to review the judgment of that court rendered in the above cause, affirming the judgment and decree of the United States District Court for the Northern District of Illinois, Eastern Division.

Jurisdiction

Jurisdiction of this Court is invoked under the United States Code, Title 28, Section 1254(1). The date of the order and judgment of the Seventh Circuit Court of Appeals was March 9, 1959.

Opinions Below

The district court affirmed without opinion the report of the special master, which is set forth in the printed copy of the record filed herewith (A. 4-153[1]). The opinion of the court below, which is also set forth therein (following A. 173), is reported in 264 F. 2d 445.

Summary Statement of the Case

This suit was brought by a number of former minority stockholders of the Joliet & Chicago Railroad Company (hereinafter called Joliet) against the defendant (hereinafter called Gulf), formerly majority and controlling stockholder, for equitable relief and damages based on defendant's stoppage of its guaranteed dividend payments on Joliet stock and its failure when buying plaintiffs' stock to disclose material facts affecting its value to the plaintiffs, in violation of its fiduciary obligations, by which unfair conduct it was enabled to reap large profits at the plaintiffs' expense. The complaint alleges two causes of action; the first relies upon diversity of citizenship, and the second on the Federal Securities Exchange Act of 1934 and Rule X-10B-5 of the S. E. C. made pursuant thereto.

Over plaintiffs' objections in open court, the District Judge referred the case, on the basis of defendant's representation that it would take at least a week to try. The special master heard the case in two days, and recommended a decree for the defendant. The District Court confirmed his report in every respect,

[1] Refers to pages of Plaintiffs' Appendix.

and entered judgment for the defendant. The Court of Appeals affirmed.

Statement of Facts

There is remarkably little in the record which is disputed. Plaintiffs rely almost entirely on the defendant's own admissions in examinations before trial, on its own contemporary records and actions, and on other contemporary documents, which were uncontradicted.

The Master and the District Court found that "there was no conflict in the evidence except on the issue of the fair value of Joliet shares in 1950." (Sum. 56, A. 30). The Court of Appeals found the evidence was "not free from conflict," but furnished "ample support for the findings made by the special Master." It made no mention of the rule that where all the evidence is in documents or depositions, an appellate court may form its own opinion without regard to interpretations of the trial tribunal. *United States* v. *Gypsum Co.*, 333 U. S. 364, 395.

Plaintiffs were the holders of an aggregate of 4,310 shares of Joliet capital stock prior to February 14, 1950; of these shares 100 were acquired by plaintiff Norwich Free Academy in 1877, 1350 by Blackstone Memorial Library before 1903, and the remainder by the other plaintiffs in 1947, 1948 and 1949. On February 14, 1950 these shares were purchased from them by the defendant through its wholly-owned subsidiary, Gulf, Mobile & Ohio Land Company. The defendant

then, and for a little more than two years prior thereto, had been the majority stockholder of Joliet, and all the officers and directors of Joliet were officials or employees of Gulf. (Findings 24, 28, 31,[1] A. 122, 123, 124, 125, 131.)

The property of Joliet had been leased in perpetuity to Gulf and its predecessors in interest for nearly one hundred years. The rental consisted of payment of $7.00 dividends per share annually to the lessor's stockholders, the lessee being bound to pay all taxes assessed on account of said dividends. Joliet was chartered in 1855 (Ill. Stat. 1855, pp. 263 *et seq.*), and its existence was made perpetual in 1861. (Ill. Private Laws 1861, p. 497.)[2] An amendment made in 1939 provided that no dividends were payable on stock registered in the lessee's name. (Findings 7-12, A. 118-120.)

Gulf acquired the lease, together with the other assets of the Alton Railroad Company, under a Plan of reorganization which was approved by the Interstate Commerce Commission in 1945, and finally consummated by decree of the Federal District Court in Chicago on May 31, 1947. (Findings 14, 16, A. 120-121.) The assumption agreement provided that the lease should be deemed a lease and not a conveyance in fee. Gulf reserved the right to litigate its liability to pay the Federal corporate income tax of the Joliet

[1] Refers to the numbered Findings of Fact in the Master's Report. (A. 118-147.)

[2] This antedated both the Illinois Constitution and the Revised Statutes, so that to dissolve Joliet certainly, and to transfer a substantial part of its assets outside the usual course of business probably, required the unanimous consent of its stockholders.

Company. At some time during this period, Gulf determined to acquire, if possible, all the stock of Joliet. (Finding 17, A. 121.)

Gulf did not pay Joliet's 1946 tax due March 15, 1947. (Finding 20, A. 122.) Federal income tax authorities filed a lien upon Joliet on January 27, 1948 and thereafter Gulf paid the Joliet dividends to the United States Treasury Department in partial satisfaction of the lien, and all payments of dividends to Joliet stockholders ceased. (Finding 35, A. 125-126.) Meantime, in the early fall of 1947, Gulf secured the *ex parte* approval of the Interstate Commerce Commission to an offer of $150. par value of its 4% bonds in exchange for each share of Joliet stock. (Finding 18, A. 121-122.)

In connection with this exchange offer, Gulf stated that if substantially all of the stock was not exchanged, it would bring an action for declaratory judgment that it was not liable to pay the Federal taxes on Joliet's income. (Finding 18, A. 121-122.)

Gulf sued for such a declaratory judgment on December 24, 1947 in the Circuit Court of Cook County, announcing at about the same time that all dividends on Joliet stock would necessarily cease until this suit was finally determined. (Finding 34, A. 125.) [1] The Blackstone Memorial Library requested that Joliet retain as its attorneys in this proceeding the firms of Fallansbee, Shorey & Schupp of Chicago and Perkins, Malone & Washburn of New York, who represented

[1] The opinion below states: "for some reason not discernible * * * dividend payments were stopped." But surely the reason was obvious—to force the minority stockholders to exchange their stock.

the Joliet Company or its minority stockholders for the previous twenty-five years in various controversies with this lessee, including the question of liability for Federal taxes. Gulf declined to designate these firms or either of them, but instead left the choice of Joliet's attorneys to its own attorney, Mr. Towner, who selected a reputable Chicago lawyer who had no previous familiarity whatever with Joliet's affairs or problems. (Sum. 173, A. 64.)

Thereupon, Blackstone Memorial and the Norwich Free Academy, two of the plaintiffs who had held their Joliet stock since the last century, brought suit in the Federal District Court in Chicago against Joliet and Gulf, demanding payment of the dividends. After trial, Judge Igoe decreed in June 1949 that Gulf was liable for the taxes, and must pay the full $7.00 dividends, with interest on those in arrears. Judge Igoe announced his decision orally on April 25, 1949, citing no authorities; he merely quoted the tax covenant in the lease, consisting of five lines. (Sum. 251-253, A. 91-93.)

The Master concluded that Gulf's conduct in 1947 and 1948 was "properly criticized by Judge Igoe in his decree and findings of June 1949," when the formal decree was entered. (Conclusion[1] 124; A. 149.) Judge Igoe's findings included the following (A. 91-93):

> "On August 27, 1947, G. M. & O. filed with the Interstate Commerce Commission its application (F. D. 15834) which was heard *ex parte,* and on

[1] Refers to numbered Conclusions of Law in the Master's Report (A. 147-153).

November 24, 1947, the Commission entered an order authorizing G. M. & O. to acquire the shares of Joliet (and shares of another lessor) upon the terms and conditions set out in such order.

* * * * *

"On the date (August 27, 1947) said application was filed with the Commission, G. M. & O., by F. M. Hicks, its Executive Vice President, addressed a letter to W. L. Price, Comptroller, the Joliet and Chicago Railroad Company, Baltimore, Md., wherein it was stated that the G. M. & O. had concluded that the lease did not obligate the lessee to pay the income tax of the lessor and that accordingly, G. M. & O. did not accept liability and did not intend to pay the Federal income tax of Joliet for the year 1946 or for later years.

* * * *

"In this period, G. M. & O., in an effort to acquire shares, was advising the shareholders of Joliet of their predictment, and emphasizing the seriousness of their situation because of accumulation of back taxes and the levy and distraint instituted by the Government, the cessation of dividends, and the reduction in payments towards the tax retirement because of the acquisition and registration of shares in the name of G. M. & O.

* * * *

"The Court finds that the interest of G. M. & O. and Joliet are adverse and officers common to Joliet and G. M. & O. have not handled and managed the affairs of Joliet to the best interests of minority stockholders of the latter company."

* * * *

> "The Court concludes that G. M. & O., as majority stockholder of Joliet and as the employer of those it selected and appointed to act as directors and officers of Joliet, stands in a fiduciary position and relationship to Joliet and to the minority stockholders of Joliet and that the employees of G. M. & O., including its officers serving as directors and officers of Joliet, stand in a fiduciary relationship to Joliet and to its minority stockholders."

Gulf appealed from the decision (Finding 41, A. 127), though the possibility of Judge Igoe's decision being set aside was practically non-existent. (Finding 111, A. 146.)

When Gulf took over the operation of the former Alton properties, on May 31, 1947, included among these were some valuable land and buildings owned by Joliet, which were thereafter used in connection with certain property of Alton (hereinafter collectively called the Harrison Street properties) as a freight terminal jointly by Gulf and Baltimore & Ohio Railroad Company. B. & O. paid 70% of the costs of this operation amounting to one million three hundred thousand dollars a year. (Sum. 84, A. 37-38.) On April 7, 1949 B. & O. gave notice of cancellation to Gulf of its participation, effective October 7, 1949. (Findings 66-69, A. 132-134.)

Gulf immediately made efforts to find some other use for these Joliet and former Alton properties or some method of disposing of them advantageously, in order to avoid the loss of one million three hundred thousand dollars in revenue with which it was otherwise confronted. It was not able to make any progress

in any direction prior to November 1949; there had been no firm bid for the properties from anyone, and the highest tentative suggestion was a price of from two and a half million dollars to three million dollars. (Findings 70-74; A. 134.)

About the beginning of November, 1949, Gulf made tentative plans to employ the law firm of Arvey, Hodes & Mantynband, of Chicago, to represent Gulf in dealing with the problems arising from the projected Congress Street Super Highway, and also to assist Gulf in disposing of the Harrison Street properties to the United States Post Office Department. On November 4th Mr. Hicks saw Post Master General Donaldson in Washington, and told him that Gulf wished to sell to the Post Office Department. He discussed with Mr. Donaldson the projected Super Highway, and told him that Gulf had in mind employing Mr. Hodes of the firm of Arvey, Hodes & Mantynband and asked Mr. Donaldson if he had any objection. Mr. Donaldson said he would be pleased to have all the help either Gulf or Mr. Hodes could give him. (Findings 75, 76, A. 134-136.) On November 19, 1949, *Gulf retained* Mr. Hodes's firm by letter from its General Attorney, Mr. J. N. Ogden, approved by Mr. Hicks, to represent Gulf in the Super Highway matter and also to assist Gulf in disposing of the Harrison Street properties to the Post Office Department. The letter also mentioned possible participation of the Chicago Union Station Company, but all further negotiations were had with the United States Government alone, and these proceeded without a hitch. (Sum. 218, A. 77.) Under the agreement Gulf paid $25,000.00 down to Arvey, Hodes & Mantynband, and agreed to pay 5% of any amount

received over two and a half million dollars. (Finding 78, A. 136.) The starting point for the 5% was fixed at two and a half million because that amount was probably available elsewhere. (Sum. 185, A. 67.)

On December 1, 1949, a Committee of the Post Office Department and the General Services Administration came from Washington and went over the Gulf's property with Gulf's officials and representatives of the Hodes office. (Findings 79-82, A. 136-137.)

The official report of this group concluded with a statement that it was the opinion of the Committee that Gulf's Harrison Street properties were probably the most desirable site available for expansion of the Chicago Post Office facilities.

The Postmaster General signed his "O. K." at the end of the report on December 20, 1949, saying "Note last paragraph." The next day he attached a note to the first page of the report, stating "I agree and we should follow rec. last par." (Finding 88, A. 139.)

Early in December Mr. Hicks lunched in Chicago with Postmaster General Donaldson, Mr. Hodes and Mr. Haderlein, the Chicago Postmaster, who knew Mr. Hodes (Sum. 222, A. 79) at Mr. Hodes's club, and Mr. Hicks agreed to let the Post Office use without charge part of the Harrison Street facilities. (Sum. 214, A. 76). Mr. Hicks also at this luncheon tried to sell to the Government the idea of buying the site (Sum. 222, A. 79) though he at first denied having done so.

The purchase required the concurrence of the Government's General Services Administration. Its head,

Mr. Reynolds, testified (Sum. 293, A. 107-108), "The basic responsibility would rest with the Post Office Department in establishing their needs."

On January 9, 1950 this Court handed down its decision in the leading tax case of *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451. This case announced a new rule under which, if Gulf dissolved Joliet and acquired its assets before sale to the Government, Gulf could deduct a resultant tax loss, even though negotiations began before dissolution. The importance of this decision was immediately headlined by the leading tax services. Commerce Clearing House, Standard Federal tax reports No. 5, January 11, 1950; Prentice-Hall, weekly Federal Tax Report Bulletin, January 12, 1950; "Taxes, the Tax Magazine", February, 1950, p. 104.

In January, 1950, Gulf ordered an appraisal of the Harrison Street property by Coverdale & Colpitts for the purpose of its sale to the Government. (Finding 85, A. 138). The appraisal cost $24,764.51. (Sum. 312, A. 114.)

On February 1, 1950, the main briefs had been filed in the pending appeal before this Court from Judge Igoe's decision and the case was awaiting oral argument. There was no change in the trend of judicial decisions in the intervening months, or in the view of Gulf's legal advisers, as to the chances of success; they did not know why Mr. Hicks decided to buy the minority stock in February of 1950 rather than await the decision on appeal. (Sum. 174, 244, A. 64, 87-88.)

About February 1, 1950 Gulf decided it could afford to pay as much as $259 a share for the minority

Joliet stock, and immediately thereafter sent Mr. Scruggs, its Consulting Engineer, by train from Mobile, Alabama, to New York City to buy the stock. His instructions were to buy at the lowest possible price,—just as if Gulf were buying General Motors stock in the open market. He approached plaintiffs through the brokers Adams & Peck, and a price of $239 net to the plaintiffs (which included $14 per share of unpaid dividends) was agreed upon. (Sum. 199, 200, 211, A. 71, 75; Findings 50-53, 55-62, A. 128-131.) The nominal purchaser was Gulf's wholly-owned subsidiary Gulf, Mobile & Ohio Land Co., which then transferred the shares to Gulf in exchange for $150 par value of Gulf's 4% bonds. The sale was ratified at a special meeting of the Gulf Executive Committee in Mobile on February 10, 1950, the minutes of which recorded the following statement (A. 169-170):

> (Mr. Hicks) "It does appear, however, that substantially all the Joliet and Chicago stock not now owned by this Company can be purchased for $240 per share each. While the management is of the opinion that circumstances justify the payment of such a price and it would be advantageous to the company to do so, the company is not in position to do it without the use of the bonds authorized to be issued in exchange for the Joliet and Chicago stock."

Adams & Peck thereafter bought all the remaining minority stock, following the same procedure, and paying the same price, except that $250 was paid for the last 17 shares on April 13, 1950. (Sum. 260, Finding 63, A. 96, 131-132.)

Fourth Assistant Postmaster Myers, who was in charge of the purchase for the Post Office Department, was very well acquainted with Mr. Hodes, as Mr. Hicks knew, though he at first denied it. (Sum. 202, 215, A. 71, 72, 76, 77.) After a telephone conversation with Mr. Myers, Mr. Hicks wrote a joint letter dated April 11, 1950 to him and to Mr. Reynolds, offering the property at $8,271,000.

The minutes of Gulf's Board of Directors dated April 14, 1950 (Sum. 250, Finding 105, A. 90-91, 144) state:

> "Mr. Hicks reported the status of negotiations for the sale to the Government of our Harrison Street facilities in Chicago. He stated that it had been hoped that the proposed sale might be consummated in time to provide funds for the purchase of needed additional equipment but since it does not now appear that this can be done, it is desired that the Board authorize the acquisition of eight new Diesel units expected to be delivered by American Locomotive Company this summer and four new Diesel units expected to be delivered by General Motors Corporation (Electro-Motive Division) about the same time, as well as 100 70-ton covered hopper cars to be delivered by American Car and Foundry Company in June, to be financed temporarily under conditional sale contracts providing for payment of the full purchase price, with interest at the rate of 2% per annum, on or before June 1, 1951, which would be assigned by the respective manufacturers to The Merchants National Bank of Mobile as Trustee in behalf of itself and associate banks."

Pursuant to application dated April 10, 1950 and filed April 13, 1950, which stated it had acquired all Joliet's stock, Gulf secured authorization on June 7, 1950 from the Interstate Commerce Commission to acquire Joliet's properties. On June 20, 1950 Gulf dissolved Joliet. (Finding 64.)

Mr. Hicks deposed on direct examination that Gulf was up against "some disability" unless it acquired all Joliet's stock, and that "I am not informed legally as to whether we could liquidate the corporations and apply the physical properties or not * * *." (A. 166.) He also deposed that "In the whole course of proceedings from the time G. M. & O. '(GULF) retained Mr. Hodes, Mr. Hodes never heard any intimation that the proceedings had struck a snag, so that they would not go through." (Sum. 218, A. 77.)

On September 13, 1951, Gulf received from the Government payment of $6,550,082.82 for the Harrison Street properties. Gulf's expenses of sale were fees and expenses to Arvey, Hodes & Mantynband, $240,368; fees and expenses to Coverdale & Colpitts, $24,764; Payment to Chicago Title & Trust Co., $24,833. (Sum. 312, A. 114.)

The amount realized by Gulf from the sale to the Government was at least $4,000,000 more than it could have realized from sale to any other person at the time. (Findings 71-75, 78; A. 134, 135, 136.)

Questions Presented

1. Was the case properly referred?

2. Is a majority stockholder, in complete control of the management of a corporation, when buying

its minority stock, bound to disclose pending negotiations for a highly profitable sale of a substantial part of the corporate assets?

3. In such a transaction, is a special tax advantage accruing to the majority stockholder through the acquisition of the minority stock a material fact which should be disclosed prior to purchase?

4. In such a stock transaction, if effected in interstate commerce, does the standard of the majority stockholder's fiduciary obligations depend upon the law of the state of incorporation, or upon Federal law?

5. Is a provision in the plan of reorganization of a railroad company approved by the Interstate Commerce Commission and the Federal District Court having jurisdiction, subject to collateral attack?

6. In such a transaction, is the majority stockholder required to disclose all prospective profits which it will make through the stock purchase, or need it only disclose profits which the minority stockholders will make if they retain their stock?

Reasons Relied on for the Allowance of the Writ

1. The decision below is in conflict with the decision of this Court in *LaBuy* v. *Howes Leather Co.*, 352 U. S. 249, as to the propriety of a reference.

2. The decision below is i conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica Corp.*, 235 F. 2d 369.

3. The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western*

Pacific R. R. Corp. v. *Western Pacific R. R. Co.*, 206 F. 2d 495.

4. The decision below is in conflict with the Federal Securities and Exchange Act and the Regulations promulgated thereunder by the Securities and Exchange Commission.

5. The decision below purports to set aside collaterally a provision in the Alton Plan of Reorganization, after final approval by the Interstate Commerce Commission and the Federal District Court.

6. The decision below is in conflict with the unmistakable trend of the decisions of all the Federal courts.

The matters set forth in the foregoing petition are hereby adopted and made part of this brief.

POINT I

The instant case is in conflict with the decision of this Court in *La Buy* v. *Howes Leather Co.*, 352 U. S. 249.

The Court below admitted that "there may be a question as to whether this was a proper case for reference," but declined to decide this question, on the ground that plaintiffs did not object. The record (A. 170-173) shows that the District Judge (serving in the same district as Judge La Buy) ordered the reference over plaintiffs' repeated objections, on defendant's representation that the trial would last a week or more (the Master finished it in less than two days). The Court below relies on plaintiffs' statement that a reference might be proper to assess damages; but this would only have taken place after an interlocutory decree in plaintiffs' favor,— an entirely different matter (*La Buy* v. *Howes Leather Co.*, *supra*, 259).

Plaintiffs submit that the reference was clearly improper, under Federal Rule of Civil Procedure No. 53, and under *La Buy* v. *Howes Leather Co.*, 352 U. S. 249; and that their opposition to the reference in open court, followed by objection to confirmation of the

report on this ground (A. 154), and argument of the point before the Court of Appeals, were adequate steps to preserve their rights. Indeed, such seems to be the normal procedure; for while this Court seemed unanimous in the *La Buy* case in deeming the reference improper, four judges dissented on the ground that mandamus was not the right remedy, and that correction of the error must await review by appeal.

This Court will readily observe the additional obstacle of expense and delay which the procedure of the District Court, not corrected by the Court of Appeals, places in the path of defrauded minority stockholders. These plaintiffs are faced with a bill of costs of over $8,000. (A. 164) in a case as simple as this, where the facts were clearly established by the depositions and exhibits, before trial, and the Master found (Sum. 56, A. 30) that "There was no conflict in the evidence except on the issue of the fair value of Joliet shares in 1950." In a really complicated factual situation, the threat of an even more staggering bill of costs might be as effective in preventing the assertion of minority rights as the decision below on substantive questions.

The abuse of references has been a matter of keen and growing interest. It was recently discussed at length by Federal District Judge Irving R. Kaufman, in 58 Col. Law Rev. 452, 455-459. We submit that the abuse in this case (initiated, as might be expected, by the defendant) was so gross, and the possible scope so far-reaching and dangerous to defrauded minorities, as to call for drastic correction by this Court.

POINT II

The instant case is in conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica*.

The decision in *Speed* v. *Transamerica Corp.* (C. A. 3) 235 F. 2d 369, affirming 99 F. S. 820, which was the culmination of a long series of preliminary decisions in the District Court and the Court of Appeals, was a landmark in the long series of judicial decisions and legislation protecting minority stockholders against predatory majorities. Professor Loss, Securities Regulations (1951 ed., p. 835) rightly described that case as "one which bids fair to become a leading case under Rule X-10 B-5." There, the defendant Transamerica Corporation was the principal and controlling stockholder of Axton-Fisher Tobacco Co. Axton-Fisher had a large inventory of tobacco, which had increased greatly in value. Transamerica decided to buy out the minority stockholders and then sell the inventory of Axton-Fisher. It circularized these stockholders, offering to buy their common stock at $12 a share, enclosing a balance sheet which showed the tobacco inventory at *cost*, not at the greatly increased market value. After acquiring substantially all the B stock, Transamerica dissolved Axton-Fisher and some time later sold the tobacco inventory (which meantime had a further large increase in value), making a profit of several hundred per cent on its stock purchases.

The plaintiff minority stockholders who had sold their stock sued Transamerica in the Federal District

Court under Rule X-10 B-5 of the Securities and Exchange Commission, contending that Transamerica intended to sell Axton-Fisher's inventory when it offered to buy their stock, and that this, combined with the failure to disclose the greatly increased earnings and the great increase in value of the tobacco inventory, violated Rule X-10 B-5. (99 F. Supp. 820.) The District Court found that Transamerica did have such an *intention* (though concededly it did not actually *sell* the inventory for a considerable time after the dissolution) 99 F. Supp. 825 *et seq.*:

> "The non-disclosure of the inventory profit according to historical and orthodox practices may have had little significance—considered abstractly. The reason could be urged that while such fact might not be known to each individual shareholder, it would, however, be known in tobacco and financial circles. This knowledge would, of necessity, be reflected or discounted in the price at which the stocks sold on the public exchanges. In fact, plaintiffs and the SEC both reluctantly admitted the asset or real value would not be a significant factor in the absence of a plan to liquidate, etc.
>
> * * * *
>
> "The price offered in the letter of November 12, 1942 was certainly a fair price to the public minority stockholders of Axton-Fisher—but only under the assumption that *no liquidation etc., was to take place.*
>
> * * * *

(p. 827:)

"Since I find the existence of such a plan to be a fact, it follows defendant must respond in damages."

(pp. 828, 829:)

"The rule is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers."

* * * *

"In this particular relationship, the injured party is not held within the limitations of the difference between price received and fair value of article sold. The injured party is entitled to require the perpetrator to disgorge gains made at the expense of the injured. I said: '* * * Some courts have called this a fiduciary duty while others state it is a duty imposed by the 'special circumstances'. I have already determined defendant was an 'insider'. As such, defendant was master of the corporate household and could not rely on arm's length dealing with its minority."

The Third Circuit Court of Appeals affirmed in all respects, except that it increased the pre-judgment rate of interest from 2% to 4%. Its opinion states (235 F. 2d 369, 373):

"In this court Transamerica does not seriously argue that the legal conclusions drawn by the

district court do not follow if the factual premise is accepted."

In *Speed*, as here, the defendant made no secret of its desire to acquire all the minority stock. The fraud in *Speed* consisted in the concealed *intent* (there being no overt action) to sell the assets of the affiliate after all the stock was acquired, rather than to continue its operation as a going business. So here, the defendant had disclosed its intention to acquire all the stock of Joliet and to take over its assets in its application to the I. C. C. in August 1947. But defendant made no disclosure when buying plaintiffs' stock in February 1950 that it then had not only the *intention* of selling for cash at a highly favorable price a considerable part of Joliet's assets, but that *negotiations for the sale were in progress and approaching consummation;* that this transaction included as an inseparable part the simultaneous sale, on equally favorable terms, of Gulf's property, the joint properties then being a white elephant on Gulf's hands, on which it had just lost a million three hundred thousand dollars a year in revenue due to the Baltimore & Ohio's withdrawal; that if Joliet were dissolved in time, the extraordinary profit of four millions from the sale could not only be realized free of tax, but Gulf would in addition benefit by a tax saving of a million and a quarter dollars; and further that probably to complete this sale, and certainly to get the tax saving, Gulf must acquire all the minority stock.

The reference in the opinion below to the *Speed* decision shows that the court did not discern its reasoning. The court says that "the huge profit" (in the tobacco inventory) "was assured before the shares

were purchased." But in fact a large part of the profit accrued *after* the purchase, for which the defendant was also held accountable. And the court below missed the main point of *Speed*, which was that the secret intention of Transamerica to sell the inventory in the future was the crux of the case; the court found that but for this intention, the price paid was fair. The future course of tobacco prices in *Speed* was much more uncertain than the sales price to the Government at a huge profit in this case, where Gulf could have accepted the Government's lowest offer at any time and still made almost as huge a net profit, due to the hidden windfall in the Joliet's tax cost. And whereas in *Speed* there was the bare intent to sell later, in the present case the defendant's negotiations had progressed so favorably that at some period prior to its directors' meeting on April 14, 1950, it admittedly expected payment before the summer! And the inference is inescapable from the conceded facts that the chief reason it did not realize this expectation was its need to buy all the minority stock and get clear title to all the property before selling it to the Government.

The court below thought it "hardly conceivable that the court in *Speed* would have reached the result it did if the plaintiff shareholders in that case had been limited in their rights as they are here." But the court in *Speed* said that the plaintiffs there got a price "some 33½% above the market price" (99 F. S. 825, which would have been perfectly fair were it not for Transamerica's undisclosed intent to liquidate, and that Transamerica "purposely failed to make the mentioned disclosures for the express purpose of inducing the minority stockholders to sell their stock at

what appeared to be a good price, but in fact, was not."

The court below said that "plaintiffs as shareholders of Joliet had no right to share in the proceeds of the sale by Gulf to the Government or in any income derived from the investment of such proceeds." It would seem more pertinent to say that without the consent of the plaintiffs and every other Joliet stockholder, Gulf probably had no right to make the sale at all, and certainly had no right to get the unrestricted use of the proceeds or the benefit of Joliet's $2,441,015. tax deduction. It is true that if the sale to the Government had by some extraordinary mischance failed to materialize, the Joliet stockholders might have only been entitled to their $7.00 annual dividends till such time as Gulf felt obliged to pay them a fair price. But so in *Speed* if Transamerica had decided *not to liquidate*, the minority stockholders would never have received the huge liquidation profits. And whenever the property was sold, Gulf would get the benefit of the hidden high tax cost of the Joliet's realty, which was thus a permanent asset.

What makes this case unique in the history of minority stockholder litigation is that Gulf was a second offender, having been found guilty of misusing its powers of control to freeze out the minority only a few months before, and consummating its second breach of trust while the appeal from the earlier decision was still pending.

POINT III

The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western Pacific R. R. Corp.* v. *Western Pacific R. R. Co.*

Perhaps the most extraordinary departure in the opinion below from well-established principles of law was its treatment of the huge tax windfall which accrued to Gulf through buying all the minority stock. The court was surprised that "plaintiffs go to the extreme position of asserting that they are entitled to share pro-rata not only in profits realized by Gulf on its sale to the Government but in tax benefits which accrued to Gulf by reason of the transaction." Beyond characterizing this "extreme position" as a "nuisance value," the court does not give any reason for disregarding this asset, except to repeat that plaintiffs were limited to $7.00 per share.

One would have supposed by now that the importance of tax benefits in valuing shares would be plain to all, for since the advent of high tax rates it has become a commonplace in all financial dealings. That it is a legitimate and sometimes a vital factor in assessing the fairness of dealings with minority stock was the key issue in the extensive *Western Pacific* litigation, which was finally decided by the Ninth Circuit Court of Appeals in 206 F. 2d 495, cert. denied, 346 U. S. 910. The court there recognized the force of Mr. Justice Jackson's pithy comments in 345 U. S. 247, 273, but in applying them found that there had been no over-reaching by the controlling interests, because "all the transactions were open and above-

board and were carried on in plain sight of all concerned," by officers of the court. What a contrast to the instant case!

The hidden tax windfall here amounted to $1,269,321.05 to Gulf. It arose because the original tax cost to Joliet of the property sold, going back to March 1, 1913 and beyond, produced a tax loss of $2,441,015. and this loss was a fully deductible ordinary loss, not a "capital loss," as erroneously stated in Finding 104. (A. 143, 144.) Ironically, the opinion below states that Joliet had "no chance for capital gains or losses," when in fact, if the plaintiffs had not sold their stock, Joliet would have realized the above loss, of practically no benefit to it or to Gulf in that event, but worth 52% of face value to Gulf if Joliet were dissolved without delay. And Gulf could only effect dissolution through buying all the stock, because its early charter date made the common law rules applicable. *Union Mutual Life Ins. Co.* v. *Frear Stone Mfg. Co.*, 97 Ill. 537, 545.

The importance of this asset in evaluating the value of Joliet minority stock to Gulf may be realized by comparing the huge tax saving with the 15,000 shares of Joliet outstanding, and the much smaller amount owned by the minority stockholders. Further, the benefit of the tax was a permanent and continuing asset to Gulf; even if its net earnings, which were four million in 1949 and eight million in 1950, as shown by Moody, had been sharply reduced in 1951 (actually they were shown in Moody as over six million), the carry-back provisions would have given Gulf the same benefits. These earnings figures are interesting as showing that the five million tax-free

profit made by Gulf from selling this white elephant to the Government (with plaintiffs' unwitting help) exceeded the total net earnings of the entire Gulf system for the year 1949!

Gulf knew on February 10, 1950 that by acquiring all Joliet's stock and dissolving Joliet before consummating the sale, it would acquire a tax loss of about two and a half million dollars, which would be realized as soon as it completed the sale. Defendant could have made its April offer just as well in February 1950, and the obvious explanation for the two months' delay was the necessity of buying up the Joliet minority stock in the intervening period. Having accomplished this, Gulf was in the fortunate position, due to the tax situation, of knowing that even if it accepted the Government's lowest offer of $5,300,000., it would realize net after taxes only about $500,000. less than it ultimately received. This amount being $3,500,000. more than it could obtain elsewhere (besides the tax saving of over a million dollars) Gulf knew at all times that it could make a highly profitable sale to the Government, and that explains why Mr. Hicks never attempted to interest any other purchasers, after he initiated negotiations with the Post Office Department with the assistance of Mr. Hodes. Moreover, even if contrary to Gulf's expectation the apparently assured Government sale fell through, Gulf would have gained by dissolving Joliet an assured ultimate tax benefit of 52% of any diminution in the price which it received from any one else for this white elephant which it intended to dispose of as soon as possible.

This was also the situation in *Strong* v. *Repide*, 213 U. S. 419, when the fiduciary had a profitable offer to purchase when he bought the minority stock, which he subsequently bettered, as Gulf did here. The attempt of the court below to distinguish the two cases seems groundless.

POINT IV

The decision below is in conflict with the decisions of the Court of Appeals for the Tenth and Second Circuits and for the District of Columbia in *Durnett* v. *Auer*, *Hughes* v. *Securities & Exchange Comm.*, and *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.*

The court below evidently assumed that the fiduciary standard required of Gulf here was fixed by the law of Illinois, for it relies on two old decisions (*Hooker* v. *Midland Steel Co.*, 215 Ill. 444, and *Bawden* v. *Taylor*, 254 Ill. 464), which held that "a director may buy from an individual stockholder practically on the same basis as from a stranger." In applying this archaic rule to the present case, even if Illinois law were the criterion, the decision below is squarely in conflict with the decision of the Tenth Circuit Court of Appeals in *Durnett* v. *Auer*, 71 F. 2d 912, which held that this Illinois rule could not apply to a plan to buy all the stock and take over all the assets of a corporation. The decision below is also in conflict with the decision of the Fifth Circuit Court of Appeals in *Mansfield Hardwood Lumber Co.* v. *Johnson*, rendered February 20, 1959, 263 F. 2d 748 (a diversity case like *Durnett* v. *Auer*, *supra*).

Further, the decision below was in error here in failing to give paramount effect to the Federal Securities and Exchange Act and the Regulations of the Securities and Exchange Commission (Rule X-10 B-5) which in interstate transactions like these would supersede any contrary State rule of law. Federal supremacy in this field was squarely upheld in *Hughes* v. *Securities & Exchange Commission* (C. A. 2), 139 F. 2d 434 and in *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.* (D. C. App.), 177 F. 2d, 228, which are in direct conflict with the opinion below on this major principle. The State of Illinois could not charter its citizens to defraud minority stockholders in other States in defiance of Federal law. And, as was said in *Zahn* v. *Transamerica Corp.* (C. A. 3), 162 F. 2d 36, 44, "The tenor of the federal decisions in respect to the general fiduciary duty of those in control of a corporation is unmistakable."

Not only is there thus a direct conflict of decision between circuits on the question whether the Federal rule as to the fiduciary duty of majority to minority stockholders in interstate security transactions is paramount to the law of the state of incorporation, but this is an important question of Federal law which has not been, but should be settled by this Court.

POINT V

The decision below is in direct conflict with an important provision of the plan of reorganization of the Alton Railroad Company, which became final on May 31, 1947, after approval by the Interstate Commerce Commission and the Federal District Court having jurisdiction.

The opinion below relies heavily on a dictum in its majority opinion (also written by Judge Major) in *Joliet & Chicago R. R. Co.* v. *United States* (1941), 118 F. 2d 174, 176, that "there is little, if any, question that the indenture of 1864 divested the plaintiff 'Joliet' of all right, title and interest in the property, and vested a full and indefeasible title in the grantee, its successors and assigns."

This dictum was based on two Illinois decisions. In the first, *Huck* v. *Chicago & Alton R. Co.*, 86 Ill. 350, the court held (pp. 354, 355) that in view of the Joliet lease provisions, including the lessee's covenant to pay all taxes on the demised premises, and of the Illinois statute which taxed railroads on property, *operated*, whether it was *owned or leased*, the lessee "is, for all purposes of taxation, if not for all other purposes, to be regarded as the owner of all the leased property." In the second, *Chicago, Burlington & Quincy R. Co.* v. *Boyd*, 118 Ill. 73, the court remarked that a Burlington indenture (terms not stated) was equivalent to a conveyance. Neither of these cases decided that Gulf here could convey title to Joliet's property; Judge Major's 1941 opinion ruled that Joliet's corporate entity could be disregarded for Federal income tax purposes, but it was unanimously

reversed by this Court. These two aspects of Joliet's ownership were the only ones involved in the instant case. In the 1941 case, Judge Major accepted the admission of Joliet (against its own interest but in favor of its majority stockholder and lessee) that it had no rights in its own property. Evidently the provisions of Ill. Rev. Stats. C. 80, sec. 8, specifically providing for forfeiture of the lessee's interest for non-payment of rent, were not called to the court's attention. No individual Joliet stockholder was a party to that suit.

Whatever the validity of these contentions of defendant's predecessors may have been in the past as applied to the various situations involved *supra*, they became moot when the Joliet stockholders required the Gulf as part of the Alton Plan of Reorganization to admit that the Joliet property was only *leased*, and not *conveyed*. This language was used to insure Joliet's stockholders against future misuse of their property by the new lessee. It was agreed to by all the parties in interest, and approved by the I. C. C. and the Federal District Court. We are at a loss to understand the statement of the court below, that it could not discern "how this provision altered a situation which had been in existence and recognized by the parties" (sic) "for almost a century." This statement is erroneous in its assumptions in the first place, but in any event it seems most usual that reorganizations in bankruptcy should change previous contractual relationships.

The action of the court below in collaterally nullifying this provision of the Alton Plan seems unprecedented.

POINT VI

The decision below is in conflict with the unmistakable trend of the decisions of all the Federal Courts in this century.

The opinion below shows an unusual blindness to the fiduciary duties required by this Court to be observed by a controlling majority stockholder like Gulf.

Even the Special Master here specifically agreed with Judge Igoe's findings in the previous case that Gulf had previously violated its fiduciary duties toward the minority stockholders. This violation (which of course could not occur till after Gulf acquired control early in 1948) consisted in continuing the stoppage of dividends as a means of forcing the minority to sacrifice their stock. The court below evidently disagreed with the Master's criticism of this conduct, for it could not discern the reason why dividend payments were stopped, though the purpose, to put pressure on the minority, seems obvious. The court further said "this contention" (of damage due to dividend stoppage) "is not pressed here,"— an error hard to comprehend in view of the following quotations from plaintiffs' main brief below:

> "This scheme was initiated before Gulf took control. * * *
>
> "But however disingenuous Gulf's course of action may have been before it took control, no violation of fiduciary duty was involved. Assumption of control created an altogether different situation. Gulf's conduct thereafter which was found wrongful by Judge Igoe was evidently

its continued failure to pay the taxes, combined with its continued warnings to the minority stockholders of their predicament. While Gulf was within its legal rights in litigating by way of a declaratory judgment its tax obligations under the lease so long as Joliet was independent, however unfounded or absurd Gulf's contentions were, Judges Igoe and Sullivan were evidently agreed that it had no right after assuming a fiduciary relation to the minority to continue its refusal to pay Joliet's taxes in order to force them to sell their stock, at least without probable cause.

"The Master specifically found (111, A. 146) that Judge Igoe's decision 'was well founded in law and the possibility of its being set aside on appeal was practically nonexistent.' But he reached the extraordinary conclusion (Conclusion 124, A. 149) that while Gulf's conduct 'in 1947 and 1948' was 'properly criticized' by Judge Igoe in his decree and findings of June 1949, those matters are not relevant to the issue in the present case, as they had no effect upon plaintiffs' judgment when plaintiffs sold their Joliet stock in February 1950, and plaintiffs were fully informed as to such matters before they sold their stock.'

"The Master evidently overlooked the fact that the main item of misconduct of which Judge Igoe found defendant guilty was in continuing to deprive Joliet stockholders of their dividends after G M & O had assumed its fiduciary obligations to these stockholders in 1948. This misconduct continued up to February 10, 1950. The continuing nature of the misconduct appears clearly from Judge Igoe's findings.

The misconduct of which Judge Igoe found the defendant guilty—the scheme of the majority stockholders to deprive the minority holders of all dividends, so as to force them to sell—of course was not limited to 1947 and 1948, as the Master supposed, but operated with cumulative effect throughout 1949 and until the plaintiffs sold their stock in February, 1950. If anything, the misconduct became more gross after Judge Igoe had held defendant liable for the taxes in his brief oral opinion on April 25, 1949 and certainly after his detailed findings in June, 1949 had put the defendant on notice that it had been and was violating its fiduciary obligations.

"If the Court below was correct in finding that 'the possibility of' (Judge Igoe's decision) 'being set aside was practically non-existent,' then it must follow that the defendant was compounding its violation of fiduciary duty by prosecuting an appeal from this decision with the apparent sole purpose of cheating its *cestuis que trust* of their current income,—a particular hardship on the two educational institutions which represent more than one-third of the plaintiffs' stock. And the conclusion seems naive (Conclusion 124, A. 149) that because the plaintiffs were fully informed of the oppression perpetrated on them, *they were not influenced* by it in evaluating their stock. Judge Igoe's finding of breach of duty was based not on fraudulent concealment, but on active misfeasance. This court will certainly take judicial notice that if the defendant had before offering to buy plaintiffs' stock dismissed its appeal from Judge Igoe's decision and

paid the arrears of dividends (which with interest would have amounted to nearly $15 a share), the plaintiffs' bargaining position would have been definitely strengthened. It needs no argument to prove that stocks receiving regular dividends generally command a better price than those paying none at all due to litigation no matter how groundless the litigation may be. And here the plaintiffs were confronted by a powerful and unscrupulous antagonist, represented by astute counsel. The Blackstone Library and the Norwich Free Academy could not pay their librarians and teachers with hopes or assurances.

"Just how much more the plaintiffs would have asked for their stock had the defendant acted conscientiously in this respect is (as often in assessing damages) a somewhat difficult question of precise amount. However, the defendant, whose breach of duty created the uncertainty, should not be permitted to profit by it, the rule being stated as follows by Judge Learned Hand in *Gratz* v. *Claughton* (C. A. 2), 187 F. 2d 46, 51, cert. denied 341 U. S. 920:

> 'The situation falls within the doctrine which has been law since the days of the "Chimney Sweeper's Jewel Case," (*Armory* v. *Delamirie*, 1722, 1 Strange 504) that when damages are at some unascertainable amount below an upper limit and when the uncertainty arises from the defendant's wrong, the upper limit will be taken as the proper amount.'

"So in *Palmer* v. *Connecticut Ry. Co.*, 311 U. S. 544, 561, the Supreme Court said in referring to an analogous case of willful infringement

of the copyright of a play by a motion picture company, 'a situation where damages are difficult of proof':

> 'No expert thought any greater percentage than ten should be attributed to the play. *The lower court allowed twenty so that the award might by no possibility be too small.* We approved because "what is required is not mathematical exactness but only a reasonable approximation." That, after all, is a matter of judgment * * *' (Emphasis supplied.)

"Here the defendant had decided it could afford to pay $244 a share plus dividend arrears. Mr. Hicks admitted (Dep. 95) that defendant was 'prepared to pay $259 if necessary.' We believe it reasonable to infer that *on the sole basis of the improvement in their bargaining position due to such assumed prior payment of the dividend arrears and dropping of the appeal* the plaintiffs would have raised their asking price from $225 (ex-dividend) to $244 per share. At any rate, it is obvious that their bargaining position would have been somewhat bettered by defendant's belated abandonment of its unlawful conduct, and under the doctrine stated by Judge Hand and the United States Supreme Court quoted *supra*, the defendant having wrongfully prevented bargaining on a fair basis, is chargeable with the highest possible figure that fair bargaining could have produced. We know that that price was at least $259, for the defendant has admitted as much. Indeed, it is arguable that as a fiduciary Gulf was bound to disclose the decision of its executives that it would pay $259 per share.

"So much for the continued active oppression of the minority by wrongful withholding of their dividends. We now turn to the fraudulent concealment of the Harrison Street situation, practiced by the defendant, which involved much larger damages."

The court below construed the above argument as not pressing the contention that the continued stoppage of dividends damaged the plaintiffs! Another curious error is its statement that "In our opinion, the most that can be said of Gulf's situation was that it was anxious, as it had been for several years, to sell the Harrison Street property, and that it had hopes, perhaps with some reason, of consummating a sale to the government." The reference to "several years" is wholly groundless, and the mistake is important, because it shows confusion in the court's mind between Gulf's long-range plan to squeeze out the minority—which did last "several years"—and the sudden necessity for sale of the Harrison Street land, which arose only in April, 1949, when the B. & O. gave notice of cancellation. This cancellation in turn led to Gulf's strenuous efforts to rid itself of the white elephant, all of which had failed when Gulf as a last resort approached the Postmaster General and retained Mr. Hodes's firm in November 1949.

Such unusual errors as those just mentioned are hard to explain, unless they were perhaps due to the fundamental misconception of the court below, based on its unsound and out-dated 1941 dictum that Joliet did not own its property, and that its stockholders had only a contractual right to $7. per share annual dividends and nothing more. This may have made the

court less careful in examining the more pertinent issues.

The same predisposition led the court completely to misunderstand Mr. Gardner's testimony that no investor would "buy Joliet stock on a yield basis at a price of $240. per share." The whole point of Mr. Gardner's testimony (A. 33-35) was that Joliet's value was *not* limited to a *yield basis*, and he referred to the analogous and well-known case of the "New York & Harlem Railroad, which is leased to the New York Central for 400 years, and which has valuable real estate interests" near Grand Central Station. It is controlled by its lessee, and is limited to a $5. annual dividend, but its stock has been traded on the New York Stock Exchange "at prices ranging from $300. to $600. per share." Mr. Hall, Gulf's expert, knew so little about guaranteed stocks that he had never heard of New York & Harlem (one of the best-known leased lines, and the closest analogy to Joliet) before the hearing, and of course "did not know what made the Harlem stock so valuable" (A. 99). The court below quoted as authoritative Mr. Hall's untenable view that "leased line securities are, in effect, bonds rather than stocks."

These unsound views, expressed below, if not corrected, would endanger the property rights of the stockholders in dozens of leased line railroads in the United States, which are controlled by their lessees. The opinion below in effect invites such lessees to violate their fiduciary duties, by placing a ceiling on their liability—the capitalized value of the guaranteed dividends—and allowing them to retain any surplus prof-

its which they may make from secret dealings with the lessor's fee ownership.

Despite Mr. Hall's contrary opinion, apparently shared by the court below, the fact is that long-term and even perpetual lessors do retain the fee ownership of their properties, and when a conveyance of the fee is required, as in the case of the Post Office deal here, or when questions of Federal income tax liability are involved, as here, and as was held by this Court in *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, the lessor's ownership must be recognized.

The same misplaced concentration on the supposed limitation on plaintiffs' rights must be responsible for the failure of the court below to apply one of the most elementary principles of fiduciary law, that the fiduciary is bound to account for the profits he makes from unfair dealings, and that his liability is not limited to the damages he inflicts on the beneficiary.

The court below also neglected the rule referred to in *Pearlman* v. *Feldmann* (C. A. 2), 219 F. 173, 177, that "fiduciaries always have the burden of proof in establishing the fairness of their dealings with trust properties." Let us bear that principle in mind in outlining below merely the highlights of Gulf's conduct.

Gulf's frantic haste in making the Joliet stock purchases proves that it was an emergency matter. Actually, defendant's "long-range plan" for Joliet had been to starve the minority into submission by an indefinite suspension of dividend payments, and this plan had still several months—possibly nine months—

of life before the appeal would be decided by the Circuit Court of Appeals (Sum. 244, A. 87, 88), with a possible further delay by application for a writ of certiorari. During this period defendant might have hoped to buy a sizeable amount of stock from tired or needy holders; Adams and Peck bought 100 shares on February 8, 1950 at 180 (Sum. 264, A. 97) and defendant might well have hoped to pick up many hundreds at near that price. True, this would have violated the Interstate Commerce Commission's order as to price, but defendant showed no hesitancy here in committing a flagrant wholesale violation of that order, through the instrumentality of its wholly-owned Land Company. Moreover, by acquiring 8,619 Joliet shares previously, defendant had already effected 57½% of the annual tax saving in Joliet corporate taxes which was a main original objective in buying the stock. Besides, Mr. Hicks testified that his lawyers advised him at this time that there was as good a chance as ever of winning the appeal.

Even if the carefully planned scheme of coercion were to be thus suddenly and inexplicably abandoned, after incurring the expense of preparing and printing the record and briefs on appeal (Sum. 244, A. 87, 88), there was no apparent reason for the emergency move of sending an important executive in person from Alabama to New York at almost a moment's notice, to stay there until the purchase of the bulk of the stock was completed, instead of merely placing the purchase order in the hands of Adams & Peck for execution; or for the further emergency move of buying overnight about $1,200,000 worth of Joliet stock in apparent violation of the Interstate Commerce Commission's order.

When Gulf began its proceedings to buy Joliet stock in 1947, it was content with the leisurely but lawful processes of the Commission, though then its routine annual taxsaving possibilities were more than double what they were in February, 1950. Obviously there was an emergency at the latter date.

We shall point out below what seem to be the only possible motives for the hasty and possibly illegal stock purchase. These motives were inextricably connected with the Post Office deal.

We have seen that January was the month when a very quick closing was expected. Mr. Hicks testified that it was in January, 1950, that he asked Mr. Scruggs to make his calculation. (Sumr. 157, A. 60.) Some time during the month of January, or February before the 6th (accepting Mr. Scruggs' date), the defendant must have been apprised of two extremely important considerations, the first seriously endangering the whole deal, and the second making it much more profitable, if consummated. The first was the fact that the government would only be interested in acquiring a clear title to the fee, a substantial part of which belonged to Joliet, not to Gulf; the second was that if Gulf could get the fee of Joliet's share before completing the sale, there was a potential net tax saving of an extra $1,200,000. Both these problems could be solved by the immediate purchase of all the minority Joliet stock and the dissolution of Joliet before title was conveyed to the government, and (as appears *infra*) in no other way.

Having the burden of proof to explain this sudden purchase, Gulf offered only two reasons—first, Judge

Igoe's decision *nine months* before, from which meantime it had been prosecuting an appeal with eminent counsel, who had printed the record and briefs; second, that a month before, it had completed the liquidation of another leased line—an uncontested proceeding begun in 1947, which was wholly irrelevant to the Joliet situation. These reasons were so trivial compared with the extraordinary emergency action of buying the Joliet stock in the circumstances outlined above, that we suggest that their only importance is to show Gulf's guilty realization that to admit the true and obvious explanation—the pending Post Office sale—would inevitably result in an adverse decree in the instant case.

Mr. Hicks himself admitted that unless Gulf acquired all Joliet's stock, it was up against "some legal disability" and he did not know if they could liquidate the corporation and "apply the physical properties" otherwise. The statement under the circumstances certainly meant that there was doubt whether Gulf could consummate the bonanza deal (of which Joliet's realty was an essential ingredient) without buying all the Joliet stock.

Mr. Hicks's doubts were fully justified. Joliet's charter antedated the present Illinois Constitution and the Revised Statutes, so that the rights of its stockholders were governed by the common law, under which their unanimous consent was certainly required to dissolve the corporation, and probably required to sell a substantial part of its assets outside the usual course of business. *Cf.* the long history of the celebrated Central of Georgia Railway litigation, finally decided in favor of the lessor's minority stockholders

on April 10, 1950. (*South Western R. Co.* v. *Benton*, 206 Ga. 770) with which Gulf's attorneys were undoubtedly familiar.

Furthermore, Gulf was now in danger of being hoist with its own petard in the pending appeal from Judge Igoe's decision in the dividend action. Evidently this litigation must be immediately ended, if Gulf was to convey a clear title to the Joliet property, as was shown by Mr. Reynolds' searching questions at the June 9, 1950 conference as to any litigation affecting title to the property. (Defendant's App. 267.) Gulf's fiduciary duty obviously required it to inform the plaintiffs of its intention to withdraw its appeal whether they sold or not. But this did not fit in with Mr. Hicks's purpose of buying their stock at the lowest possible price, as if Gulf were buying General Motors stock, and so it was concealed till after the stock purchase.

A clinching proof that the stock purchase was integrally bound up with the Post Office deal is also found in Gulf's own minutes. Mr. Hicks informed Gulf's Executive Committee on February 10, 1950 that "circumstances justify the payment of such a price * * *;" and later, on April 14, 1950, stated to Gulf's Board of Directors "that it had been hoped that the proposed sale might be consummated in time to provide funds for the purchase of needed additional equipment (next summer), but since it does not now appear that this can be done," the equipment purchase should be financed temporarily till June 1, 1951. In view of Mr. Hicks's admission that after employing Mr. Hodes' firm he never had any intimation that the Post Office negotiation had struck a snag, this last-

quoted statement can only mean that at some time between November 1949 (when Mr. Hicks saw the Postmaster General on November 4, 1949 and retained Mr. Hodes' firm on November 19th and gave up all attempts to sell to others) and April 14, 1950, Gulf deemed the sale to the Government as not only assured, but as so imminent that it could be closed, and the price collected, before summer, and further that, at some later date prior to April 14, 1950, the expected date of closing was postponed to about June 1, 1951 (actually, Gulf was paid September 13, 1951), the assurance of ultimate sale being undiminished.

The undisputed admissions and circumstances already set forth raise an inescapable inference that the Joliet stock purchase was an integral part of the Harrison Street sale. But further circumstances combine to associate the two with almost mathematical precision, especially as Gulf, carrying the burden of proof, has offered no other rational explanation either of the sudden stock purchase or of the minutes.

There being 180 days between November 4th and April 14th, a purely arithmetical interpolation would point to January 23, 1950 as the likeliest approximate date when Gulf determined that the closing must be deferred till 1951.

Mr. Hicks already had Mr. Hodes's firm in mind to handle the business, and when the Postmaster General indicated approval, he retained Mr. Hodes on November 19, 1949 with a $25,000. fee, plus a 5% contingency. Knowing Mr. Hodes's intimate connections with the Post Office Department in particular and with the Democratic Administration in Washington

in general, Mr. Hicks must have felt quite hopeful when he had secured his services. His hopes must have risen far higher when things began to happen so fast immediately following Mr. Hodes's retainer. The Postmaster General came to Chicago to lunch with him, the Chicago Postmaster Mr. Haderlein (who knew Mr. Hodes) and Mr. Hodes at the latter's club in Chicago early in December, after a large delegation from Washington, together with Gulf officials and representatives of the Hodes office, had inspected the defendant's properties on December 1. This Committee made a full report of their trip on December 14, 1949.

The Postmaster General signed his "O. K." at the end of the report on December 20, 1949, saying "Note last paragraph." The next day, to make assurance doubly sure, he attached a note to the report, stating (again in his own handwriting) "I agree and we should follow rec. last par." (recommendation last paragraph). This expressed the opinion of the Committee that Gulf's Harrison Street properties were probably the most desirable site available for expansion of the Chicago Post Office facilities.

With respect to the above evidence (all documentary, or undisputed, and hence subject to unrestricted review by an appellate court) the court below said: "Although the evidence is not free from conflict, we are convinced that it furnishes ample support for the findings made by the special master, relevant portions of which are:

> "92. Prior to February 10, 1950, GM&O (Gulf) had no knowledge or information that the gov-

> ernment was giving Harrison Street property consideration more favorable than it was giving other Chicago sites proposed for acquisition by the government."
>
> * * * *

The above quotation indicates that the court below applied a wrong criterion to the special master's finding, apparently thinking it was bound to affirm unless the finding was clearly erroneous. But even if the latter criterion were applied the finding should not stand. For it seems perfectly incredible that Mr. Hodes, who was paid a fee of $235,000. for effecting the sale, and whose work was highly satisfactory to Mr. Hicks (Sum. 224, A. 80), would not have promptly found out from his good friend Walter Myers or Mr. Haderlein, or from the Postmaster General, what the attitude of the Post Office Department was. Such disclosure would not have violated any statute that we are aware of, and it is hard to understand Mr. Hicks's implication that such disclosure would have been a violation of open dealing (Sum. 206, A. 73).

The purchase required the concurrence of the Government's General Service Administration, but as its head Mr. Reynolds testified "The basic responsibility would rest with the Post Office Department in establishing its needs." None of the Post Office officials ever wavered in their preference, after December, 1949, and Fourth Assistant Postmaster General Myers, who "was very well acquainted with Mr. Hodes," was in charge of the purchase throughout for the Post Office. Mr. Post, one of the signers of the report, was General Services' representative on the Committee. (Sum. 98, A. 43-44)

Indeed, Mr. Myers was perfectly frank in championing Gulf's cause, at conferences with Messrs. Hicks and Ogden in June, 1950, both in Mr. Reynolds' presence and in his absence (Defendants' App. 270, 273), and Messrs. Myers and Reynolds advised Gulf how it could help them get Congressional approval. Incidentally, when on June 28, 1950 Gulf officials told Mr. Fisher, General Manager of the Chicago Union Station, and a Mr. Shiffer, "that the Government was going to buy all of our property," this "did not appear to be any news to them." (Defendant's App. 279). Neither Mr. Myers nor Mr. Reynolds saw anything wrong in advising Gulf openly how it could best secure acceptance of its offer, and Mr. Myers surely would have felt free to disclose the favorable attitude of all his colleagues to Mr. Hodes after his chief had adopted the report on December 21st.

But the surest proof of the clear error of the master and the court below on this point is found in Gulf's April 14th minutes. For how could Mr. Hicks have hoped to get paid before summer, and how could he still expect to be paid by June 1, 1951, unless he had been informed of the favorable attitude of the Post Office officials from the Postmaster General down? If in fact Mr. Hicks believed (as the master found) that the government (in this case represented by the Post Office Department) was giving equally favorable consideration to other sites, then his statement to the Directors would have been wildly reckless and foolish, instead of being remarkably accurate, as it proved.

Even more pertinent to the stock purchase was the second branch of Mr. Hicks's April 14th statement,—

that at some date *after* hope of immediate closing arose (in late December or January), but *before* April 14th, Gulf realized the closing must be deferred for over a year. Gulf proffered no evidence in explanation, but the inference is inescapable that the reason for the unexpected delay was the necessity of dissolving Joliet before conveying title, which in turn required buying all the Joliet stock as an essential condition precedent. For Mr. Hicks admitted that no snag in the procedure was even intimated to him at any time, and further that there was doubt if Gulf could dissolve Joliet and sell its property without buying every share. And Gulf's only extraordinary activity during this period was the stock purchase—hasty to the point of illegality as to plaintiffs' stock, followed by two months of mopping up the remaining scattered shares,—and the equally hurried dissolution of Joliet immediately thereafter. Again, in contrast to the leisurely dissolution proceedings in the other leased line, which took two years, Gulf completed Joliet's dissolution in two months.

Mr. Hicks's admissions, borne out by Gulf's actions, seem consistent only with the hypothesis that Gulf had to buy the stock to complete the Post Office deal. Gulf has suggested no other rational explanation for its Herculean efforts, which fitted in with such chronological exactitude into the Post Office negotiations.

If needed, further corroboration was at hand. When Gulf first dealt with the Post Office Department, it described the whole property as its own. This appears in its retainer of the Hodes firm (Defendant's App. 252), which refers to "disposing of certain property which we own and to which we customarily

refer as our Harrison Street properties;" and also from the Government committee's report the following month, which recommended "Gulf's Harrison St. properties." This was the time when Gulf hoped to complete the sale before summer. But in January, 1950, it must have occurred to some one that Gulf could not in any event convey good fee title to Joliet land; that the Government would not buy land, partly fee and partly leasehold, or any land the title to which was adversely affected by pending litigation; Mr. Ogden, Gulf's lawyer, admitted he might have talked with Mr. Hodes about the difficulty of selling a leasehold, and such a conversation must have taken place *after* November 19, and *before* February 10, when it became irrelevant.

Another vital element leading to the stock purchase was Joliet's tax asset; this meant a million and a quarter dollars to Gulf if it could dissolve Joliet before closing the realty deal (see p. 26-27 supra). And by a remarkable coincidence this potential tax bonanza as it affected the Post Office deal was confirmed on January 9, 1950 by this court in the leading case of *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451. This case announced a new rule under which, if Gulf dissolved Joliet and acquired its assets before sale to the Government, Gulf could deduct a resultant tax loss, even though negotiations began before dissolution. The importance of this decision was immediately head-lined by the leading tax services. Even if one could imagine that Gulf's tax advisers had not studied the tax angles of this crucially important realty deal earlier, this widely-publicized decision must surely have caught their attention.

Finally, if the court below had seriously analyzed the conduct of this cynical second offender, it could never have been so naive as to accept the master's finding that the reason why Gulf did not disclose any of the above facts to plaintiffs was its belief that the disposal of Joliet's Harrison Street properties in this hugely profitable package deal was none of their business. The truth is that Gulf's motive in concealing these highly favorable elements of value in 1950 was exactly the same as its motive in 1948, so justly criticized both by Judge Igoe and the master, in cutting off Joliet dividend payments—in both cases, to buy the minority's stock at the lowest possible price, which Mr. Hicks admitted was Gulf's intention. Actuated by this point of view, which was so improper for a fiduciary, Gulf would only by inadvertence have revealed anything to plaintiffs that would have possibly raised their asking price. And the record is crystal clear that Gulf made no such mistake, and disclosed absolutely nothing.

We respectfully submit that the decision below is not only most unjust to the minority stockholders directly involved, who after being over-reached by a faithless fiduciary are unjustly faced with a monumental bill of costs, but also would probably deprive all minority stockholders obliged to seek relief in the Seventh Circuit of the protection against predatory insiders which the Congress, the Securities & Exchange Commission, and this Court have tried to build up, particularly in the last 25 years. Indeed, this decision would set back fiduciary standards by at least a century.

CONCLUSION

It is respectfully submitted that a writ of certiorari should be granted.

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